Remarks to Senate Finance Committee

Farnum Building 210

By Michael LaFaive

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Thank you for inviting me to speak about our state business tax and possible alternatives. As you know, the MBT is a complex and widely hated business tax that replaced an equally complex and widely hated business tax.

Michigan is the only state to suffer *negative* economic growth between 2000 and 2009. Likewise, it's the only one that actually lost population. One thing that hasn't changed since 2000 is the recipe to make it better: After nearly a decade of the status quo, we need bold strokes to untie Michigan's Gordian Knot of tax, labor and regulatory laws. On the tax side, "bold" means eliminating the MBT altogether and making up the foregone revenue with spending cuts.

In 2006, the Legislature green-lighted a voter-initiated law to repeal the Single Business Tax. That citizen-initiated law began with a purpose statement: "(To) encourage the legislature to adopt a tax that is less burdensome and less costly to employers, more equitable, and more conducive to job creation and investment."

It's hard to believe that even with these instructions the Legislature cobbled together the MBT and surcharge, a tax that failed to meet the "explicit objectives set forth in the law" mandating an SBT replacement.

I'm about to break some news you will find of interest: The well-respected Tax Foundation in Washington, D.C., publishes an annual State Business Tax Climate Index comprised of five sub-indexes. Each state is ranked on things like the presence or absence of particular taxes, rates, revenues extracted and more.

In the sub-index for corporate taxes, Michigan ranked 48th in 2010.

At our request, the Tax Foundation re-ranked Michigan based on the "what if" of adopting Gov. Snyder's proposal to replace the MBT with a flat corporate income tax. Without even factoring in the possibility of a net tax cut, the Tax Foundation reported that our corporate tax ranking would rise from 48th to 22nd place.

Let me repeat that: Without even reducing the annual revenue haul, just switching to a simpler business tax — one that doesn't impose an annual liability even if your business loses money — moves Michigan out of the basement on this important measurement. The large leap is explained by the fact that maintaining a gross receipts tax counts heavily against a state's ranking.

How important is the Tax Foundation measure? In 2005, four independent scholars analyzed several different business climate studies and found that, yes — state growth *is* affected by tax climate — and also that these indexes do a good job of accounting for growth — or lack thereof.

So, if Michigan can vault 26 places in this ranking by just adopting a simpler tax — one that doesn't sock it our entrepreneurs and investors even when they're losing money— imagine the impact if we eliminated the business tax altogether, and replaced it with nothing.

As it turns out, we don't have to imagine very hard. The top states in the Tax Foundation's overall ranking share something in common: they do not levy one of the major taxes — corporate, personal or sales. The Tax Foundation writes, "the lesson is simple; a state that raises sufficient revenue without one of the major taxes will, all things being equal, out-competes those states that levy every tax in the collector's arsenal."

By the way, the Mackinac Center has examined the growth rates of the 10 states that get by without one of those major taxes. We found that since 2000 (and ending in 2009), these states enjoyed average real state GDP growth of 22.4 percent while those that have all three taxes grew only 13.4 percent. Maybe that's just coincidence — taxes aren't the only factor that contributes to state growth and decline — but I wouldn't want to bet on it.

How might our jobs landscape look if we eliminated the MBT and surcharge and replaced it with nothing? We crunched some numbers using a "Computable General Equilibrium" economic model, and came up with a **very conservative** estimate of 120,000-plus net new jobs through 2016, even if Michigan makes no other changes to improve its business climate.

I want to emphasize just how conservative this estimate is. The model forecast for future economic data is based on past experience, and this one is based on growth rates going back to 2000 — not a good decade for Michigan. So you can see why our model understates the jobs impact.

Second, this model doesn't capture the benefits of every little change to the structure of a tax. Structure matters, because hyper-complex tax systems that impose punitive administrative and compliance costs obviously raise the cost of doing business here. Simplifying the tax is good, but eliminating it is even better, because then our businesses can invest in what they do best instead of paying accountants to comply with convoluted tax laws.

There's another benefit rarely discussed in Lansing, but of growing concern back in your districts: A lot of entrepreneurial activity in the past decade has gone into wheedling selective tax breaks out of you and the MEDC, rather than the improving of products and services to make businesses more competitive. Eliminating the state business tax would greatly reduce all this favor seeking, and research shows this has real a real impact on a state's economy.

Specifically, a study by Harold Brumm, an economist at the Government Accounting Office in Washington, D.C., has found a statistical link between economic growth and the amount of so-called "rent seeking" in state capitals — and it's a negative one. States that encourage rent seeking have slower growth — and with all the special credits, zones, MEGA grants, subsidies, "refundables," etcetera that this Legislature has carved out in recent years, Michigan is one of the worst offenders.

That's why the Mackinac Center has been so critical of imposing a complex business tax and then inviting favor-seekers to petition for special treatment under it. Getting rid of both the business tax and the related favor-seeking would be an economic growth "two-fer" for the Great Lakes State. Incidentally, one of the reasons our model's jobs estimate is so conservative is because this additional benefit is not factored in.

To put it another way, for years Michigan has run a schizophrenic tax policy: Pretending that tax hikes imposed on the many don't matter, while offering special breaks that hopefully prevent the handful of favored recipients not to go elsewhere. But if these discriminatory tax breaks work for a few corporations, why not for all?

I know Gov. Snyder has talked about phasing out MEGA — much to his credit — but wouldn't it be better to just make it obsolete altogether by eliminating the Michigan business tax that those special deals reduce?

Under a static analysis, eliminating the MBT and surcharge would reduce state revenues by around $2.2 billion. That would be on top of a projected budget deficit of $1.8 billion. So how might we close the deficit and still let job providers here keep more of what they earn?

The Mackinac Center has published hundreds of ideas for saving billions of dollars. One study has more than 200 ideas that would save $2 billion without touching the School Aid Fund and hardly touching Medicaid. Other articles and studies describe devolving state police road patrols, privatizing the University of Michigan, privatizing some prisons and much more.

More recent Mackinac Center research provides evidence that government benefit packages in Michigan exceed private-sector averages every year by $5.7 billion. Defenders of those out-of-balance benefits try to muddy the water with their version of apples and apples comparisons, but facts are stubborn things, and even in government $5.7 billion is real money.

To put this in perspective, that's enough to wipe out a $1.8 billion deficit every year, eliminate the MBT and surcharge, spend an additional $1 billion fixing the roads and still leave $700 million for the rainy day fund or more tax cuts elsewhere.

The $5.7 billion is spread among all levels of government here — state, university, college, K-12 and local. But — *if you have the will* — the statutory means are available for the state (and state taxpayers) to realize most of those potential savings, without imposing new burdens on other levels. In other words, with just a few exceptions, the old excuse of "we can't do that" isn't true. As for "we don't want to do that" — well, that's between you and your constituents.

My point is, where there's a political will there are countless cuts and reforms that can provide the requisite savings for a bold elimination of the state's primary business tax. Doing so would end the debate between, say, manufacturers and other businesses over the fairness of the tax, and eliminate the need for special favors like MEGA credits. It would also send a resounding message worldwide that Michigan has abandoned the status quo, is unwilling to remain a poor state and is once again a friendly place to do business.

Thank you for your time and attention.